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Delaware Court of Chancery Rules Noncompetition Clause Unenforceable By Subsidiaries Unless Identified in Agreement

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In Frontline Techs. Parent, LLC v. Murphy (Aug. 23, 2023), the Delaware Court of Chancery rejected enforcement of former employees' noncompetition restrictions because the agreement language did not prohibit competition with the company, only the company's private equity owner. The court dismissed the case and reinforced that if private equity companies want to limit post-employment activities of portfolio company employees through restrictive covenants, they "should ensure their contracts say what they mean and mean what they say."

Background:

Defendant former employees were employed by Frontline Technologies Group, LLC (Frontline), a wholly owned subsidiary of Frontline Technologies Parent, LLC (Parent). Parent, in turn, was owned by a private equity firm. In exchange for equity in Parent, the two former employees entered into equity agreements with Parent and entities related to the private equity owner. Notably, Frontline itself was not a party to the equity agreements.

The equity agreements contained noncompetition provisions that restricted the employees' post-employment activities for one year. But the noncompetition language was tailored to the "business" or "business line" of Parent, not Frontline. The defendants, however, were employed by Frontline — not Parent — and the equity agreements made no mention of Frontline.

The defendants resigned from Frontline and shortly thereafter began employment with a Frontline competitor. Frontline and Parent sought an injunction to enforce the noncompetition restriction, relying solely on descriptions of Frontline's business to define the scope of competition, not Parent's business. Perhaps recognizing the problems the contract language created, Frontline and Parent also sought equitable rescission of the agreements based on a claimed mutual mistake that all parties believed the employees would be restricted from competing with Frontline.

Analysis:

The court first rejected Frontline and Parent's request for an injunction and later dismissed the case in its entirety. Relying on the plain language of the agreements, the court determined that the agreements restricted the former employees only from competing with Parent, not Frontline.

If Frontline and Parent had wanted the noncompetition provisions to apply to Frontline's business, they could

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have defined “competition” to expressly identify Frontline. They also could have included Parent’s affiliates (such as Frontline) within the noncompetition scope. But because they failed to do so, the court ruled, Frontline and Parent “must now live with the restrictive covenants they agreed to.”

The court also dismissed Frontline and Parent’s claims for equitable rescission, concluding that no mistake of fact had occurred, and that rescission was not available to save plaintiffs from the enforcement of an unambiguous (if poorly drafted) contract.

Takeaway:

When interpreting a contract, Delaware courts will give priority to the parties’ intentions as reflected in the four corners of the document. The precise words matter, even if one or more parties may have had other intentions. When a private equity company or its portfolio companies enter into restrictive covenants with portfolio company employees, extra care should be paid to ensure that the scope of the restrictions is drafted in the way the parties meant. Otherwise they risk a court enforcing the language as-written even where it does not fully reflect the intended scope.

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